Independent Market Operator

MRCPWG

Minutes

Meeting No.	7
Location:	IMO Board Room Level 3, Governor Stirling Building, 197 St Georges Terrace, Perth
Date:	Thursday 17 February 2011
Time:	Commencing at 3:15 to 4:45pm

Attendees	
Troy Forward	IMO (Chair)
Greg Ruthven	IMO
Monica Tedeschi	IMO
Johan van Niekerk	IMO (Minutes)
Brad Huppatz	Market Generator
Pablo Campillos	DSM Aggregator
Neil Gibbney	Western Power
Neil Hay	System Management
Geoff Glazier	Sinclair Knight Merz (SKM) (3:15 – 4:15pm)
Apologies	
Shane Cremin	Market Generator
Corey Dykstra	Market Customer
Steve Gould	Market Customer
Patrick Peake	Market Generator

Item	Subject	Action
1.	**WELCOME AND APOLOGIES / ATTENDANCE** The Chair opened the 7th meeting of the Maximum Reserve Capacity Price (MRCP) Working Group (Working Group) at 3:15pm. Apologies were noted from Mr Shane Cremin (Market Generator), Mr Corey Dykstra (Market Customer), Mr Steve Gould (Market Customer) and Mr Patrick Peake (Market Generator).	
2.	**MINUTES OF PREVIOUS MEETING** The minutes of the 6th MRCP Working Group meeting, held 20 January 2011, were circulated prior to the meeting. There were no amendments to the minutes and the Working Group agreed to publish them as final.	

Item	Subject	Action
	Action Point: The IMO to publish Meeting 6 minutes on the website as final.	**IMO**
3	**ACTION POINTS** Where actions were not completed Mr Ruthven noted the following: • AP36: The IMO will present a draft updated Market Procedure, allowing for the inclusion of inlet cooling in the power station costs, to the next meeting on 24 March 2011. • AP37: The IMO to initiate a review of the relationship between humidity rates and generator output across a range of locations. This review is still pending. Mr Ruthven confirmed this should be completed in time for the meeting in April. • AP38: The IMO to seek clarification from SKM on the components included in its assessment and seek advice on whether they consider there is a better way to determine Margin M. The Chair questioned whether the Group was confident that the process for calculation of Margin M by SKM was sufficiently robust and transparent. It was agreed that the following actions would be taken: *Action Point: SKM to provide a document with a brief synopsis behind the methodology for generating each component of Margin M.* *Action Point: The IMO to engage an engineering consultant to undertake an exercise to independently provide a Margin M calculation for comparison purposes.* • AP40: Mr Ruthven advised that the Economic Regulation Authority (ERA) was continuing its work on an alternative Debt Risk premium methodology. It was anticipated that this would be available prior to the 24 March 2011 meeting. • AP 43: It was noted that the discussions between SKM and Western Power regarding Connection Costs would be discussed under the next agenda item.	**SKM** **IMO**
4	**DEEP CONNECTION COSTS – DRAFT REPORT** Mr Geoff Glazier confirmed that SKM had prepared a model as agreed which had been provided to Western Power to populate with data. Mr Glazier advised that the figures produced under the recommended methodology resulted in significantly lower Total Transmission Costs (TC) of approximately 30% of the value determined under the current methodology for the 2011 MRCP. Mr Glazier outlined the current discrepancy in definitions between the Market Procedure and Western Power regarding shallow versus deep connection costs and shared versus direct connection assets. Mr Glazier confirmed that it was SKM's opinion that while it was outside their scope, there were good grounds to consider the use of Total Connection Costs (TCC) as the basis for calculating TC.	

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	Mr Glazier advised that it was simpler to use this basis for the calculation of TC as it would be problematic, although still possible, for Western Power to extract Deep Connection Costs (DCC) under the current methodology as there was no clear division between shallow and deep connection costs. Mr Glazier explained that the primary reason for the significantly lower value of 30% (of the current method value), under the proposed methodology was that recent connections were typically opportunistic in accessing transmission connection, confirming that this was not necessarily what was envisioned when the current methodology was agreed. Mr Glazier confirmed that to some extent the use of the forecasting margin would give some scope for adjusting the TC result on an annual basis. It was noted that whilst the projected costs continued to be calculated based on a model 160MW Open Cycle Gas Turbine (OCGT), the preferred methodology utilised input data including that in respect of smaller generators in order to have a large enough sample size and in order to access annual actual access offer data. Mr Glazier confirmed that in respect of the current year, actual connection offers from Western Power were used. There could be issues if there were no access offers in any future years but that allowances could be made if such a situation arose. Mr Glazier confirmed that the preferred methodology was based on the approach of an efficient capacity provider connecting to the network, balancing all expenses including land and connection costs. The Chair asked, and Mr Gibbney confirmed he was comfortable with SKM's proposed methodology. In addition Mr Gibbney stated that while he didn't disagree with SKM's proposal it would likely see a downward movement in TC. Mr Brad Huppatz questioned whether adoption of the preferred methodology would sufficiently incentivise prospective investors. Mr Neil Hay stated that the process should aim to not only seek economic efficiency but also useability as well as encourage prospective investors to not only seek out least cost connections but also those that result in overall system reliability. Mr Glazier advised that many new connections were being made near existing switchyards where there was available capacity (spare connection bays) possibly leading to savings in the region of $3-4M for new entrants when compared with the current methodology. Mr Glazier confirmed that it was envisioned that there would not be undue volatility in TC from year to year but that SKM could in conjunction with Western Power produce a trend-line graph with no scale to provide a signal to prospective investors on the likely future trend in costs. *Action Point: SKM in conjunction with Western Power to produce a trend-line graph of the trend in TC.* Mr Glazier advised that efficient participants would most likely continue to find innovative and economically efficient ways to connect to the network and that as a result this should be taken	**SKM/Western Power**

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	into account in the process of generating the TC for the MRCP process. Mr Glazier outlined the weightings used within the preferred methodology and that the challenge was to calculate the long run marginal cost of network connection while ensuring that year on year changes in connection costs were reasonably stable. The Chair stated that in his opinion the process seemed reasonable, however suggested that due to there being a relatively large number of Members missing from the meeting that it would be best to continue the discussion at the next meeting. *Action Point: Include ongoing discussion of Deep Connection Costs Report on agenda for next Meeting.* It was confirmed that that there was an awareness of issues surrounding data and generation plant size for inclusion in modelling, and that care would need to be taken to ensure that the inclusion of small generation projects did not lead to undue downward bias in the TC calculation. It was agreed that SKM would provide more detail surrounding the forecast margin at the next meeting and continue discussions with Western Power leading up to the next meeting to provide additional clarity surrounding data used for TC calculation. *Action Point: SKM to provide more detail surrounding the forecast margin and data validity at the next meeting.*	**IMO** **SKM**
5	**WEIGHTED AVERAGE COST OF CAPITAL METHODOLOGY – UPDATED DRAFT REPORT AND MEMBER FEEDBACK** Mr Ruthven confirmed that the updated Draft Report was included in the agenda pack and detailed the feedback that had been received from Members. Mr Ruthven explained the IMO's recommendation to include debt issuance costs in the Weighted Average Cost of Capital (WACC) calculation and to remove those same costs from Margin M in the Deep Connection Cost (DCC) calculation in order to avoid any overlap. The Working Group agreed to accept the IMO's recommendation regarding debt issuance costs. *Agreed Outcome: Debt issuance costs to be included in the WACC calculation and no longer included in Margin M within the DCC calculation.* It was noted that, contrary to the recommendation of PwC, the gearing ratio would be maintained at 40% as the Group believed there was no compelling argument for change. *Agreed Outcome: Gearing ratio to be maintained at 40%.* It was agreed that the WACC report from PwC would be accepted on that basis and once the report was updated it would be published. *Action Point: IMO to publish final WACC report.* Mr Ruthven confirmed that the IMO would go ahead with the	**IMO**

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	revision of the Market Procedure taking account of the agreed revisions.	
6	**SUBMISSIONS FROM 2011 MRCP DETERMINATION** Mr Ruthven detailed the issues raised in submissions received during the 2011 MRCP determination. It was confirmed that the current basis for calculation of escalation factors was to use historical price movements to escalate prices forward to the coming year. Mr Ruthven confirmed that the IMO had held discussions with SKM surrounding forward looking models and that SKM have a well established methodology for providing information to regulatory authorities including the Australian Energy Regulator (AER), particularly for switchyard and transmission construction costs. Mr Ruthven confirmed that the weightings used by SKM for the power station capital cost were based on observations of private entities which have less visibility than regulated entities (e.g. network operators). The weightings for this escalator were developed specifically for this paper and have not been refined over several years, as is the case for the switchyard and transmission cost escalators. Mr Pablo Campillos queried as to whether any other party could provide this. In order to provide more clarity in this area it was agreed that this could be reviewed at the same time as the external review of Margin M as discussed earlier in the meeting. *Action Point: IMO to engage an engineering consultant to independently provide a view on forward-looking cost escalation factors.* With regard to insurance costs Mr Ruthven confirmed that these were not included in the fixed Operating Costs as the level of these costs were dependent on plant utilisation and that this should be priced-in based on the generators expected energy sales based on utilisation levels, which ultimately were a variable cost. It was noted by the Working Group that this may not be the case for a peaking power station with a 2% capacity factor. The comments regarding volatility in the MRCP were noted and it was agreed that further discussion, if required, would take place in future meetings. Regarding comments surrounding the variability of land parcels in differing locations it was agreed that any further discussion, if required, would take place in future meetings. The comments regarding the term to be used (currently 15 years) for recovery of capital costs in the MRCP calculation were noted. It was agreed that the IMO would distribute a summary of the impact of any change in the period used on the MRCP, in time for the next meeting. *Action Point: The IMO to provide a summary of the impact of an increase in the period used on the MRCP.*	**IMO** **IMO**
5	**GENERAL BUSINESS** Mr Huppatz queried whether allowance was made for expected	

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	refund exposure within the MRCP calculation. It was noted for an OCGT that this would likely be in the region of 1-2% over the life of the plant. It was agreed that it was reasonable to include this on the agenda for discussion at the next meeting. *Action Point: Include an agenda item for discussion of the impact of refund exposure within the MRCP calculation process.*	**IMO**
6	**NEXT MEETING** Mr Ruthven noted that the next meeting would be held on Thursday 24 March 2011.	
7	**CLOSED:** The Chair declared the meeting closed at 4:45 pm.	